DEPARTMENT OF STATE REVENUE

04-20120254.LOF

Letter of Findings: 04-20120254
Gross Retail Tax
For the Tax Years 2008-2010, and 2011

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ISSUE

I. Sales and Use Tax – Imposition.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-4-1; IC § 6-2.5-9-3; IC § 6-8.1-5-1; IC § 6-8.1-5-2; 45 IAC 2.2-4-1; 45 IAC 2.2-4-2; 45 IAC 2.2-5-15; 45 IAC 2.2-8-12 Frame Station v. Indiana State Department of Revenue, 771 N.E.2d 129 (Ind. Tax Ct., 2002); Allied Collection Service v. Ind. Dep't of State Revenue, 899 N.E.2d 69 (Ind. Tax Ct. 2008); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Sales Tax Information Bulletin 14 (December 2002); Webster's II New Riverside University Dictionary (1st ed. 1988).

Taxpayer protests the assessment of sales and use tax.

STATEMENT OF FACTS

Taxpayer is an Indiana company in the business of marketing, advertising, and event planning. The Indiana Department of Revenue ("Department") conducted a sales/use tax audit of Taxpayer for 2008, 2009, and 2010 tax years and issued proposed assessments for additional amounts of sales tax, use tax, and interest. The Department determined that Taxpayer failed to collect and remit sales tax when Taxpayer transferred tangible personal property to its customers with a mark-up included above what Taxpayer paid for the property when it was procured. Taxpayer was also billed for the tax year 2011 after the audit was concluded. Since the 2011 assessment is based on the conclusions of the audit, the 2011 assessment is also included in this protest.

Taxpayer protested the audit's assessment of sales tax for its failure to collect tax. A hearing was held, and this Letter of Findings results. Additional facts will be provided as necessary.

I. Sales and Use Tax – Imposition.

DISCUSSION

The Department notes that all tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Pursuant to IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. IC § 6-2.5-1-2 defines a retail transaction as "a transaction of a retail merchant that constitutes selling at retail as described in IC § 6-2.5-4-1... or that is described in any other section of IC § 6-2.5-4." A retail transaction is defined as occurring when a person "acquires tangible personal property... and transfers that property to another person for consideration." IC § 6-2.5-4-1(b)(1)-(2). Additionally, IC § 6-2.5-4-1(c)(2) provides that it "does not matter whether the property is transferred... alone or in conjunction with other property or services."

Accordingly, as a general rule, gross retail income includes the amounts from all charges, whether or not they are separately stated, that represent the transfer of tangible personal property and services that occur prior to the transfer of that tangible personal property.

A service does not constitute tangible personal property, and the sale of services falls outside the scope of the gross retail tax. However, in "mixed transactions," tangible personal property is either sold in order to complete a service contract, or services are preformed in order to complete the sale of tangible personal property. This often makes it difficult to distinguish between the taxable sale of property and the non-taxable sale of services. Allied Collection Service v. Ind. Dep't of State Revenue, 899 N.E.2d 69 (Ind. Tax Ct. 2008), recently explained "mixed transactions" as follows:

> [T]he legislature has set forth several parameters for imposing tax on these transactions. First, taxable property does not escape taxation merely because it is transferred in conjunction with the provision of non-taxable services. A.I.C. § 6-2.5-4-1(c)(2). Second, services, generally outside the scope of taxation, are subject to tax to the extent the income represents "any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records." A.I.C. § 6-2.5-4-1(e)(2). Finally, services are also subject to tax if they are provided in the course of a retail unitary transaction, "a unitary transaction that is also a retail transaction." Ind.Code Ann. § 6-2.5-1-2(b) (West 2003). A unitary transaction is a transaction that "includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." Ind.Code Ann. § 6-2.5-1-1(a) (West 2003).

Id. at 72.

Furthermore, in Frame Station, Inc. vs. Indiana Dep't of Revenue, 771 N.E.2d 129 (Ind. Tax Ct. 2002), the Tax Court held that when customers were charged separate amounts for labor and materials for custom framing services, the labor charges were subject to sales tax. Id. at 131. In arriving at that decision, the court reasoned that the question is "whether [Taxpayers'] services were preformed before or after it transferred property to its customers." Id. The court found that services that are performed prior to the transfer of the property are taxable, and services that are performed after the transfer of the property are taxable to the extent that the services represent a "unitary transaction" and are "inextricable and indivisible" from the property being transferred. Id. Accordingly, the determinative fact is when the services were performed.

IC § 6-2.5-4-1(e) states:

> The gross retail income received from selling at retail is only taxable under this article to the extent that the income represents:
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> (1) the price of the property transferred, without the rendition of any service; and
>
> (2) except as provided in subsection (g), any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records.
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> For purposes of this subsection, a transfer is considered to have occurred after delivery of the property to the purchaser.

Therefore, there are two instances when an otherwise non-taxable sale of a service is subject to sales tax. The first is when services are performed before the transfer of tangible personal property. IC § 6-2.5-4-1(e). The second is when the services are part of a retail unitary transaction. IC § 6-2.5-1-2. A unitary transaction is defined as a transaction that includes the transfer of tangible personal property and the provision of services for a single charge pursuant to a single agreement or order. IC § 6-2.5-1-1. A retail unitary transaction is a unitary transaction that is also a retail transaction.

A registered retail merchant is responsible for collecting and remitting sales tax on retail transactions. "The retail merchant is required to collect the tax [due on the retail transaction] as [an] agent for the state." IC § 6-2.5-2-1(b). The retail merchant "has a duty to remit Indiana [sales] or use taxes... to the department, [to] hold those taxes in trust for the state, and is personally liable for the payment of those taxes, plus any penalties and interest attributable to those taxes, to the state." IC § 6-2.5-9-3(2). Thus, when a retail merchant fails to collect and hold the taxes in trust for the state, the retail merchant is personally liable for the sales tax, interest, and penalties due to the state for those sales.

Taxpayer has not registered with the Department as a retail merchant. Taxpayer argues that it is a service provider, and not a retail merchant. Taxpayer purchases items for its clients, and it pays sales tax on the purchase of the items. Taxpayer's invoices to its customers sometimes include separately stated charges for products and services; in other instances, the products and services are listed as one charge. In either case, when Taxpayer invoiced its clients for the products, the amount Taxpayer charged its clients for tangible personal property was greater than what Taxpayer paid for the tangible personal property. Taxpayer did not collect sales tax on the charges for the tangible personal property. Taxpayer maintains that additional amount charged is a "procurement fee," meaning that this is a service charge for the work that Taxpayer put into researching the best priced items for its client, the time it took to purchase and possibly picking up the item, and so on. The Department disagreed, and determined that this was simply "markup." The Department's Sales Tax Information Bulletin 14 (December 2002), 26 Ind. Reg. 914, addresses purchases and sales by advertising agencies and, in relevant part, states:

> **Purchases by Advertising Agencies for Their Clients:**
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> If an agency relationship exists between the advertising agent and his client, the principal, the agent may pay the sales tax for the principal when the advertising agency makes purchases of personal property in the client's behalf in the process of performing his services, (e.g., printing plates, photographs, advertising brochures). The agency may then seek reimbursement from the client at the time of billing. Similarly, if the purchase by the advertising agent is for an exempt organization and if the agent is duly authorized by his client to do so, then the agent may execute an exemption certificate using the client's Registered Retail Merchant Certificate Number and signing as agent for the client.
>
> Failure of the agency to pay the sales tax on purchases as outlined above shall not relieve the principal of liability for the tax due.
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> **Retail Sales by Advertising Agencies:**
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> The transfer of tangible personal property for a consideration shall constitute a retail sale by the advertising agency and is subject to Gross Retail Tax unless transferred to the principal for whom the agency purchased the tangible personal property as outlined in the above paragraph.

As illustrated in Sales Tax Information Bulletin 14, Taxpayer transferred tangible personal property for consideration, and was not merely seeking reimbursement, because additional consideration was added to the amount that Taxpayer paid for the tangible personal property. This creates a new and separate retail transaction, and sales tax is due on the full amount.

Taxpayer argues that tax should not be charged on the "procurement fee," because this is a service, and not a "markup." One could make the argument that the additional amount added to the purchase price is to cover the costs of procurement, but that would still fit the definition of "markup" ("An amount added to a cost price in calculating a selling price, esp. an amount that takes in to account overhead and profit." Webster's II New Riverside University Dictionary 728 (1st ed. 1988)). Even if the markup were a service, as mentioned above, a service provided prior to transfer of the property is subject to sales tax. Further, this "service" is also included on the invoice as one unitary transaction with property with which it is associated. Again, as mentioned above, when services are part of a retail unitary transaction, the service is subject to sales tax. IC § 6-2.5-1-2.

Taxpayer also argues that it paid sales tax on the items that it sold to its customers. Taxpayer argues that to require Taxpayer to charge sales tax on the items when it transfers the items to its customer would be taxing the same item twice. However, the audit already took that into account. Taxpayer's invoices were reviewed, and in instances where taxes were paid by Taxpayer on items it purchased for its customers, Taxpayer was credited with a refund for the sales tax paid. This is in accordance with 45 IAC 2.2-5-15, which provides that:

(a) **The state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who purchases the same for the purpose of reselling**, renting or leasing, **in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser**.

(b) General rule. Sales of tangible personal property for resale, rental or leasing are exempt from tax if all of the following conditions are satisfied:

(1) The tangible personal property is sold to a purchaser who purchases this property to resell, rent or lease it;

(2) The purchaser is occupationally engaged in reselling, renting or leasing such property in the regular course of his business; and

(3) The property is resold, rented or leased in the same form in which it was purchased.

(c) Application of general rule.

(1) The tangible personal property must be sold to a purchaser who makes the purchase with the intention of reselling, renting or leasing the property. This exemption does not apply to purchasers who intend to consume or use the property or add value to the property through the rendition of services or performance of work with respect to such property.

(2) The purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. Occasional sales and sales by servicemen in the course of rendering services shall be conclusive evidence that the purchaser is not occupationally engaged in reselling the purchased property in the regular course of his business.

(3) The property must be resold, rented or leased in the same form in which it was purchased.

(**Emphasis added**).

In the case at hand, if Taxpayer had been a registered retail merchant, it would not have had to pay sales tax on items that it would be reselling to Taxpayer's customers (see 45 IAC 2.2-8-12). Nevertheless, Taxpayer would then have to charge and collect sales tax when it resold the items on the full amount charged, including the markup or "procurement fee."

Taxpayer contends that there are inconsistencies between the various worksheets in the audit and the figures on Taxpayer's invoices to clients. In some cases, these "inconsistencies" are examples of unitary transactions involving both tangible personal property and a service, in which case the total amount charged in the unitary transaction is subject to sales tax, and therefore not an inconsistency. IC § 6-2.5-1-2.

In other examples of "inconsistencies," Taxpayer notes that certain paper receipts were not included on the refund worksheets. Three of the receipts show that sales tax was not paid by Taxpayer on the item it resold to a customer, so it was not necessary to have included them on the auditor's sales tax refund worksheet, because there was no sales tax to credit to Taxpayer. The non-taxable purchases from another receipt were not included on the auditor's sales tax refund worksheet; however, since the spreadsheet does include the taxable amount and taxes paid from the receipt, which are the only relevant information for purposes of the refund calculation, this is not an issue. Taxpayer refers to another receipt that is not reflected on the sales tax refund spreadsheet; however, Taxpayer did not provide a copy of the receipt, and based on the mid-January 2007 date of the client's invoice, it is reasonable to assume that the reason it was not included was because the tangible personal property was purchased in 2007, and therefore would have been outside the three year statute of limitations to claim a refund for the sales tax paid on that property. IC § 6-8.1-5-2(a). Only one receipt Taxpayer provided is incorrectly reflected on the sales tax refund spreadsheet and which did affect the sales tax refund amount (Invoice 09-094, purchase from DCG). Therefore, this receipt will be sent back to the auditor for an adjustment.

Taxpayer notes further "inconsistencies" in instances where Taxpayer was charged for sales tax on some unitary transactions on an invoice and not on other unitary transactions on the same invoice. In point of fact, there are some inconsistencies in that regard, but these inconsistencies actually benefit Taxpayer, because Taxpayer should have been charged additional sales tax on all unitary transactions, regardless of whether they were separately stated or not. In the case of separately stated charges for services performed prior to the associated

tangible personal property being transferred, even though they are separately stated charges on the invoice, these are still subject to sales tax. 45 IAC 2.2-4-1 explains:

> (a) Where ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail unless the seller is not acting as a "retail merchant".
>
> (b) All elements of consideration are included in gross retail income subject to tax. Elements of consideration include, but are not limited to:
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> (1) The price arrived at between purchaser and seller.
>
> (2) Any additional bona fide charges added to or included in such price for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other services performed in respect to or labor charges for work done with respect to such property prior to transfer.
>
> **(3) No deduction from gross receipts is permitted for services performed or work done on behalf of the seller prior to transfer of such property at retail.** (**Emphasis added**).

In the instant matter, there were instances where Taxpayer listed on its invoices design and preparation services as separate charges from the charges for tangible personal property upon which it rendered the design and preparation services. Taxpayer, like the taxpayer in Frame Station, provided design and preparation services on a variety of different tangible personal property that it resold to its clients. Similarly, many times Taxpayer recorded separate subtotals on the invoices, one for the services and the other for the property when Taxpayer billed its customers. On some of the invoices provided by Taxpayer, where the services were separately stated from the items, the audit calculated the sales tax due on only the price of the tangible personal property, not on the separately stated price for design and preparation. However, in actuality, Taxpayer's services were performed prior to the transfer of the property and, therefore, constitute taxable transactions pursuant to Frame Station. To the extent that these "inconsistencies" occurred in the audit, they actually benefit Taxpayer.

Another "inconsistency" Taxpayer notes involves the possible use of Taxpayer's own "back-up worksheets." These worksheets were internal documents that Taxpayer's employees used to list the amount paid for items, the income made on those items, the design costs to charge, and the total amount billed to Taxpayer's customers. Taxpayer wanted these "back-up worksheets" to be used by the auditor, because they show the design costs and product costs as separately stated items. Taxpayer claims that the auditor informed Taxpayer that it could not use Taxpayer's own "back-up worksheets" in order to calculate taxes owed; however, Taxpayer points to instances where the only way the total taxable amount from the invoices could be determined would be if the auditor referred to Taxpayer's "back-up worksheets." However, even if this was the case, it appears that this would actually benefit Taxpayer, as, for instance, Taxpayer should have been assessed sales tax on $4,870 charged on a specific unitary transaction on one of Taxpayer's invoice, as opposed to the $2,625 figure that may have come from Taxpayer's "back-up worksheet."

Finally, Taxpayer points out one invoice (10-109) where the total taxable amount appears to be $20 more than it should be. Taxpayer appears to be correct, and this will be submitted to the audit section to determine whether this should be adjusted.

In terms of the 2011 assessment, the Department's audit did not consider the records for 2011, as that year was outside of the scope of the audit. Instead, the 2011 billing was based on the best information available. Taxpayer provided a list of invoice numbers, with the taxable dollars and tax due stated in separate columns. However, Taxpayer did not provide any invoices or any other documentation to back this up, and therefore Taxpayer has not met its burden of proof to show that the 2011 assessment is incorrect.

In summary, Taxpayer has failed to meet its burden of proof to show that the audit's assessments are incorrect. Taxpayer is a retail merchant and must register with the Department as a retail merchant. It may then purchase tangible personal property without paying sales tax using the exemption certificate it obtains from the Department. When the tangible personal property is sold to its customers, Taxpayer must collect sales tax on the tangible personal property and services performed prior to transfer of the property, regardless of whether the amounts for the property and services are separately stated. Taxpayer must also collect sales tax on the markup it includes in the transfer price of the property. Taxpayer provided two examples of invoices from 2012, and while Taxpayer has apparently started to charge sales tax on the markup, it appears Taxpayer is also still paying sales to its vendors when it purchases items for resale.

FINDING

With the exception of certain adjustments noted above, Taxpayer's protest is respectfully denied.

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